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**CITY OF MOUNTAIN VIEW**
**MEMORANDUM**

DATE: January 17, 2003

TO: City Council

FROM: Robert F. Locke, Finance and Administrative Services Director
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SUBJECT: JANUARY 21, 2003 STUDY SESSION—REVITALIZATION AUTHORITY POTENTIAL BONDING CAPACITY AND POSSIBLE PROGRAMS AND PROJECTS

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## INTRODUCTION

One of the powers of the Mountain View Revitalization Authority (Authority) is its ability to issue debt to finance projects in the Revitalization District area (Attachment 1) and to repay it using tax increment. The Authority is limited in terms of timing for the issuance of debt. Under current redevelopment law, the Authority cannot issue debt later than January 1, 2004. This memo discusses the Authority's time line, bonding capacity, financing mechanisms and the programs and categories of projects that could be funded if the City/Authority maximizes its bonding capacity. The purpose of this study session is to review with the City Council/Authority the impending phase out of the Authority, its potential bonding capacity and possible programs and projects that could be funded using the Authority's bonding capacity. The potentially very significant impact of the Governor's redevelopment proposals will also be reviewed.

Staff has been working for several months on the bond issue necessary to finance construction of the downtown parking structure approved by Council last June. This study session was scheduled prior to release of the Governor's State budget proposal for next year which affects the ability of the City/Authority to issue this debt and the timing of the issuance. The Governor's budget for Fiscal Year 2003-04 contains a major proposal that would transfer a significant portion of annual tax increment revenue from redevelopment agencies (RDAs) to finance the State's school funding obligation beginning next fiscal year (effectively transferring local property tax to the State). The percentage of tax increment to be transferred is proposed to increase each year until all tax increment is reallocated to the State. No details regarding the proposal are available as of this writing.

Existing legislation explained in this report provides for the phase out of RDAs in 2009 and retirement of all outstanding debt by 2019. It is not known how the Governor's proposal will change existing law and the time frame for the phase out of RDAs. Because it is not known if the Governor's proposal will be successful or how it will be implemented and because the impending phase out has not been discussed with Council, it was decided to proceed with the study session.

## BACKGROUND

### Revitalization Authority Time Line

The Revitalization Authority was created in 1969. Under current redevelopment law, the Authority will cease operation on April 9, 2009 and may only continue to make payments on outstanding debt after that date until April 9, 2019. The Authority is also limited in terms of timing for issuing new debt. Under the current Revitalization Authority Plan and State law, debt may not be issued after January 1, 2004. Given this deadline, the City Council / Authority may want to consider issuing debt prior to this deadline for all or some types of the programs described later in this memo.

Under State law, the Authority has the option to extend the January 1, 2004 time limit. However, by extending this time limit, the Authority would be required to forego 25 percent of any additional increment to the various affected overlapping taxing authorities (County, school districts, etc.). In addition, the April 9, 2019 deadline would not be extended. If the indebtedness deadline was extended, it would reduce the Authority's bonding capacity due to tax increment being diverted and a shorter repayment period.

### Revitalization Authority/Indebtedness Capacity

The Revitalization Authority was created with the express purpose of reinvesting property tax increment generated within the district to eliminate blight and to revitalize and redevelop the downtown. Over the years, the City / Authority has invested over $100 million in the downtown with the Castro Street reconstruction project, the Civic Center and Center for the Performing Arts, the Public Library and the Downtown Transit Center, all with the expectation that it would attract and encourage private investment to the downtown area.

During the past few years, the City has seen significant private investment in the downtown with over 200 residential units, 270,000 square feet of office space and 40,000 square feet of retail space developed. This investment has resulted in a significant increase in the Authority's tax increment. Tax increment revenue has grown from $780,000 in Fiscal Year 1994-95 to $2.5 million in Fiscal Year 2001-02. With this increase in property tax increment, it provides the Authority the capacity to issue additional debt of up to $19.0 million. Approximately $8.5 million of this capacity has been earmarked for the new downtown parking structure. The balance of this capacity could potentially be used to finance various revitalization programs and projects, including housing. In conjunction with any new bond issue, provided a certain level of savings can be achieved, staff would recommend refinancing the 1995 Certificates of Participation (COPs). See further discussion below.

**Refinancing of Existing Debt**

In conjunction with the new bond issue, staff is recommending refinancing the 1995 COPs that refinanced the original 1987 debt issued for the reconstruction and renovation of Castro Street. When government debt is refinanced, the existing debt is paid in full by the new debt (either called or bond proceeds deposited with the trustee until the old debt is retired). The public agency is relieved of its legal obligations for the old debt which are assumed by the trustee, and the debt is removed from the agency's financial reports.

The feasibility of this refinancing depends on interest rates at the time of issuance and whether sufficient savings in interest expense can be achieved. Rates on municipal debt, while low by historical standards, have been moving up as the stock market has rallied in the last month or so. Savings need to be 2 percent of total debt service or greater to warrant a refinancing such that the interest expense savings exceed the costs of issuance. The refinancing is further discussed later in this report.

**Governor's Budget Proposal**

The Governor's budget proposal released on January 10, 2003 included $250 million of redevelopment tax increment State-wide be diverted to schools with the amount gradually increasing until 100 percent of redevelopment tax increment is shifted. This would translate to approximately 25 percent of the Authority's annual tax increment in Fiscal Year 2003-04. In 1992, the State took millions of dollars of property tax revenues (known as the Educational Relief Augmentation Fund (ERAF) shift) from cities and redevelopment agencies (RDAs). The ERAF shift for cities continues today, whereas the

RDA shift was limited to three years. With the adoption of the State's Fiscal Year 2002-03 budget, the ERAF shift for RDAs was reenacted for one year. The Authority's shift for the current year is estimated at $74,000. However, if the current Governor's proposal is adopted, the ERAF shift is estimated to be approximately $750,000 and gradually increase until the total $3.0 million (current Fiscal Year 2003-04 tax increment estimate) is transferred.

In the past, there has been strong opposition to ERAF shifts from RDAs as issuing bonded debt is one of the primary financing mechanisms for RDAs to achieve their purposes. The tax increment is used to secure the debt service payments on bonds. If the State interferes with the revenue stream of RDAs, this could have a devastating impact on the municipal bond market. Because of this concern, previous tax increment shifts from RDAs were only diverted on the amount remaining after bond payments. However, previous legislation enacted with RDAs' ERAF shifts included provisions that if there were insufficient funds available to meet the State dollar target after debt service payments, any shortfall would be withheld from the local agency (city or county). <u>This would mean that if there were insufficient funds after debt service for the Authority to meet its share of ERAF, the remainder would be withheld from the City's General Fund property tax revenues</u>.

Another proposal of the Governor that impacts RDAs is to divert, for educational purposes, all uncommitted Housing Set-Aside Funds.

In addition, the Bush Administration has proposed making corporate dividend income tax-exempt. This would negatively impact the municipal bond market as, currently, municipal bonds are Federal and State tax-exempt, providing a significant tax advantage over corporate bonds. If the Bush proposal is approved, the interest rate on municipally issued debt could double in order to compete with corporate bonds and thereby increase the costs of infrastructure financed by public agency bonds.

Staff had intended to request authorization from Council to proceed with the refinancing and bond issue for the parking structure on January 28. However, the combination of these uncertainties makes it impossible for staff to recommend moving forward with a bond issue at this immediate time. The purpose of this study session is to provide the Council with the necessary background information regarding the time lines, the bonding capacity and potential uses of bond proceeds by the Authority with the hope that this project can proceed in the near future. Staff will return to Council for this authorization in the future should these complications resolve in a manner that does not risk General Fund revenues or cause unreasonably high interest rates.

**Bonding/COPs Structure**

The City / Authority could issue debt in the amount of up to $22.0 million in Certificates of Participation (COPs) based on current tax increment revenue levels. The COPs could be issued for three purposes: (1) to refinance the outstanding 1995 COPs at a lower rate; (2) to finance construction of the Downtown Parking Structure No. 2; and (3) bond reserves, if required, and potential other capital projects described below. Refunding the 1995 COPs is proposed at a principal amount not to exceed $8.0 million. A maximum principal amount of $8.5 million is proposed for the funding of the parking structure and $2.0 million for bond reserves, if needed. Additional capacity of $3.5 million is available for other capital projects if desired by Council. If a surety bond is not economically feasible or cannot be obtained, approximately $2.0 million of the issuance will be required for bond reserves.

An important aspect of this financing is extending the City's credit rating to the Authority in order to obtain lower interest rates on the debt. From a credit perspective, the Authority cannot earn a high rating due to its relatively small geographic size and significant concentration of tax increment in a few large properties. It is not unusual for cities to assist their redevelopment agencies in this way. However, the City's General Fund would be required to guarantee debt service payments. Attachment 2 provides a more detailed description of the bond / COP financing mechanism and fiscal impact.

The following programs / projects could be funded using the bonds / COP funding mechanism:

1. Downtown Parking Structure No. 2 — $8.5 million

   On June 11, 2002, the City Council authorized staff to proceed with the design of a four-story, five-level, aboveground parking structure with approximately 20,000 square feet of retail space and to proceed with the issuance of bonds to finance a portion of the structure. It is estimated that the cost for the parking structure will be approximately $14.0 million. Funding sources include Parking District and Revitalization Authority funds, parking in-lieu fees, developer contributions and bond proceeds.

2. Refinancing Existing Debt — $8.0 million

   In 1986, the Revitalization Authority issued $9.9 million of debt to assist with the renovation of the downtown area. This debt was refinanced in 1995 in order to take advantage of lower interest rates. Now, with interest rates at record lows, it may be a propitious time to once again take advantage of savings that are possible by refinancing at lower rates. It is also very efficient to do the refinancing in combination with a planned debt offering in terms of costs and staff time.

3. Reserve Funds and Other Capital Programs and Projects — Up to $5.5 million

a. Reserve Funds

The financing agreements would require a reserve fund be established at an amount equal to the annual debt service. A surety bond may be able to be purchased in lieu of cash funds placed in reserve. If it is not economical to purchase a surety bond, approximately $2.0 million of bond proceeds would be required to be placed in a debt service reserve. If a surety bond is purchased, the $2.0 million would potentially become available for other Authority purposes.

b. Other Potential Capital Projects

In 1986, the Authority issued debt to make improvements to the street, lighting, landscaping and sidewalk improvements to renovate the downtown. Over the years, some of these street/sidewalk improvements have aged and need to be updated.

Also, during the past two to three years, the City Council has adopted a variety of initiatives to improve the appearance and to attract new retailers to the downtown. These initiatives include:

- Downtown Retail Recruitment Strategy that includes a review of the existing Facade Improvement Program and the attraction of a grocery store or pharmacy (Attachment 3).
- Conditional Use Permit Ordinance (Attachment 4).
- Interim Urgency Ordinance for Historical Preservation (Attachment 5).
- Initiated the second phase of updating the Downtown Precise Plan (Attachment 6).

Bond proceeds could potentially be used to support some or all of these initiatives or any other legal purpose of the bond proceeds that Council chooses. With the increase in tax increment, the City / Authority could also bond for additional funds to be used for affordable housing. However, until the impacts of the Governor's budget are clearer, staff is recommending deferring further actions for issuing debt.

**Internal Portfolio Investment**

Staff considered the possibility of issuing additional debt for potential property acquisitions (to promote redevelopment of blighted properties) and to leverage Housing Set-Aside Funds. However, after discussion with bond counsel regarding the complexities of using the proceeds of tax-exempt debt to acquire property or for potential housing initiatives, other alternatives were pursued. Bond counsel suggested the Authority could issue legal, but not publicly tradable, notes that would be purchased by another City fund as a portfolio investment. Staff will pursue this alternative following the debt issuance for the parking structure, if appropriate, and will make a recommendation to the Council / Authority in the future.

**Potential Programs/Projects and Financing**

The table below is a summary of the potential programs and projects, proposed funding mechanisms and amounts.

| Funding Mechanism | Program/Projects | Amounts |
|---|---|---|
| Bonding / COPs | Downtown Parking Structure | $ 8.5 Million |
| | Refinancing Debt | $ 8.0 Million |
| | Capital Projects, Other Projects and Bond Reserves | Up to $5.5 Million |
| | **Subtotal** | Up to $22.0 Million |
| Internal Fund Portfolio Investments | Potential Downtown Property Acquisitions | $ 5.0 Million |
| | Housing | $ 6.0 Million |
| | **Subtotal** | $11.0 Million |

| | | |
|---|---|---|
| | **TOTAL** | $33.0 Million |

**NEXT STEPS/COUNCIL ACTION**

The following would be the proposed next steps and actions if the City/Authority proceeds with the bond issue:

1. Once there is a clearer picture of the potential impacts of the Governor's proposal related to shifting tax increment funds from redevelopment agencies to schools, staff could return to the Council/Authority for the following actions:

    - Hold a public hearing to authorize the use of tax increment for other capital projects; and

    - Adopt a resolution approving the refunding of 1995 Certificates of Participation and funding the Downtown Parking Structure No. 2 and other capital projects.

2. After development of potential property acquisitions or other potential projects, return to the Revitalization Authority for authorization to issue up to $5.0 million in nonpublicly tradable notes to be purchased by another City fund.

3. Depending on State actions, return to the Authority at a subsequent meeting for authorization to issue up to $6.0 million of a nonpublicly tradable note to be purchased by another City fund for additional housing.

Staff is available to answer questions.

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Attachments:
1. Map of the Mountain View Revitalization District
2. City Council Memo—November 21, 2002 Revitalization Authority Parking Garage and Refinancing Debt Issue
3. City Council Memo—Downtown Retail Recruitment Strategy
4. City Council Memo—Conditional Use Permit Ordinance
5. City Council Memo—Interim Urgency Ordinance for Historical Preservation
6. City Council Memo—Work Program for Downtown Precise Plan Update